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# FVCCF UPDATE 94 -1

APRIL 1994

AN INFORMATION RELEASE FOR **FISHING VESSEL CAPITAL CONSTRUCTION FUND** AGREEMENT HOLDERS

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*Periodically we plan to provide information updates on the administration of Fishing Vessel Capital Construction Funds. Please let us know topics you would like to see discussed in subsequent UPDATE releases.*

*A number of initiatives are now in process at NMFS to review files for missing documents and clear a backlog of paperwork. In addition, it appears that the Internal Revenue Service is taking increased interest in FVCCF tax deferrals and withdrawal qualifications.*

*We suggest that you review the requirements of your FVCCF Interim Agreement and attached amendments to be certain that you are complying with all terms of the agreement. All documentation must be in order before we can make a determination of the validity of CCF deposits or whether withdrawals made may be treated as qualified under the agreement. Also, this information is also necessary before an agreement can be terminated. If FVCCF transactions are not properly documented on a year-by-year basis, these records may be difficult to locate.*

## Code and Regulations Governing the Fishing Vessel Capital Construction Fund

The FVCCF agreements are administered by the Department of Commerce (NOAA/National Marine Fisheries Service) using Commerce regulations and joint regulations with the Department of Treasury (Internal Revenue Service).

Upon request, we will supply copies of code and regulation sections governing administration of the Capital Construction Fund. Important documents for your library include:

Section 607 of the Merchant Marine Act, 1936, as amended (46 U.S.C. 1177)  
50 CFR, Part 259.30 through 259.38 (Interim Fishing Vessel Capital Construction Fund Procedures)  
26 CFR, Part 3.0 through 3.11 (Department of Treasury, Internal Revenue Service, Capital Construction Fund Rules and Regulations)

Other important references include:

Internal Revenue Code Section 7518  
Internal Revenue Service Publication 595, *Tax Guide for Commercial Fishermen*  
(updated and issued annually)

1976 Proposed Rules

Caution should be taken when using the 1976 Joint Proposed Rules (Federal Register, Vol 41, No. 20, published January 29, 1976) as a basis for handling CCF agreement transactions. Neither NMFS nor the Internal Revenue Service is bound by these proposed rules.

A major frustration to agreement holders and their representatives has been the lack of guidance in handling many transactions. We will communicate using this **UPDATE** format as new information is released by the Internal Revenue Service.

Records and Reports

We are aggressively working to clear a backlog of paperwork. Also, we are initiating systematic file review procedures which will, in many cases, require additional documentation. (Please see Interim Capital Construction Fund Agreement, Article X, Records and Reports.)

Agreement holders and Representatives may receive a number of requests for information or documentation in the near future. Your attention to supplying these items will speed our review and allow us to be more responsive to your requests.

We must clear open items in a timely manner. Failure to respond will, therefore, be considered a failure to meet substantial obligations of the FVCCF agreement which requires that the agreement be terminated, and may cause substantial penalties for nonqualified withdrawals.

Record Keeping Requirements For FVCCF Accounts

Records supporting all CCF transactions and fund activities must be kept until the agreement is officially terminated. The Federal statute of limitations then controls. Since this record keeping requirement may cover a number of years, consider establishing a permanent file for each agreement holder's FVCCF accounting records. Support for deposits, withdrawals, basis computations, vessel depreciation, and disposition records may be needed many years later.

IRS Publication 595 - Tax Guide for Commercial Fishermen

The 1993 version of Publication 595 has expanded and clarified the explanation of FV Capital Construction Funds. We suggest obtaining Publication 595 each year because IRS instructions for the Fund are still evolving. The telephone order number for IRS is 1-800-829-3676.

For those Individual taxpayers filing Form 1040 returns *and who must also complete Form 6251 (Alternative Minimum Tax - Individuals) or worksheets for Schedule D*, please note the enclosed notice from IRS explaining an error in Publication 595 concerning the correct manner to adjust taxable income carried to those forms.

Physical Deposit of Funds is Required

Recent IRS audits have brought to our attention that some agreement holders have become lax in handling their CCF accounts. After the effective date of your FVCCF agreement, **all deposits must be made into the CCF Depository** designated in your agreement. This physical deposit is required even if the funds are immediately withdrawn to reimburse the general fund for qualified expenditures on a Schedule B vessel. Failure to do so risks the validity of the deposits as deductible against fishing income.

If you wish to use a new depository account (bank or investment), please request the addition or change by letter. The CCF Interim Agreement will be amended to show the new depository.

Permission Required for Withdrawals

*Caution:* **No** withdrawals from the FVCCF account may be made without prior permission from NMFS. We can only ratify an otherwise qualified withdrawal if the request for ratification is received and documented in our files *before the tax return due date* (with extensions) for the tax year in which the withdrawal was made. (However, a withdrawal of an overdeposit may be made without permission before the tax return is filed.)

The regulations do not give leeway for later ratification of withdrawals. (50 CFR Sec 259.33(d). Lack of permission for any withdrawal may be considered a failure to meet a substantial obligation of the agreement; the entire fund or any portion of it may be treated as a nonqualified withdrawal.

NMFS permission is also required for nonqualified withdrawals. Permission may occasionally be granted for verifiable hardship. The tax penalty provisions described on page four still apply to these funds. Without NMFS permission, the CCF agreements may be terminated.

Completed Objectives

Permission to withdraw is conditional upon timely receipt of all documentation of the expenditures as required by the contract and amendments. (See 50 CFR Sec 259.37) The withdrawal permission letter specifies documents required. In many cases, agreement holders have neglected to document the completion of an objective by supplying this documentation. A review of the status of each Schedule B is needed each year. Please review the status of each Schedule B objective every year, perhaps while completing the Deposit/Withdrawal report.

*Caution: Paperwork must be completed for the withdrawals to be considered qualified.*

Loan Documents Required

When making principal payments on a vessel mortgage using FVCCF funds, a copy of the note must be on file showing the origination date, lender, and terms of the loan. Loan documents must only be submitted one time unless terms of the loan change.

For each year that principal payments are made, submit:

- An amortization schedule covering the period showing actual payment dates of principal payments made or a statement from the noteholder showing this information, and
- A basis recomputation for the vessel at the beginning and end of taxable year. If this has not previously been prepared for and submitted to NMFS, please prepare the basis computation, including annual adjustments to date.

*Caution: Basis of the vessel is reduced as of the date that the mortgage payment is actually made (not the date of reimbursement if actual payments were disbursed from the vessel's general fund).*

*Under Treasury Regulation Sec. 3.6(d), a method of accounting may be adopted to adjust basis on the first day of the tax year for payments actually made in the first half of the year; for payments actually made during the second half of the year, basis is reduced on the first day of the succeeding tax year.*

Preparing Deposit/Withdrawal Reports

A recent survey of NOAA Form 34-82 forms submitted with tax returns revealed a number of errors and inconsistent treatments. Please be certain that each transaction is detailed, giving the date, Vessel that is the source of income or object of expenditure, and dates of each transaction for which general fund reimbursements are made.

Sample forms, general and detailed directions are enclosed. Please review these directions; many experienced preparers are not using the form correctly. Please prepare supporting schedules if income deposits cannot be easily traced to the agreement holder's tax returns. A supporting schedule is also needed for reimbursements to a general fund covering a number of small disbursements.

Frequent errors include:

- Including unrealized gains or losses as additions or subtractions from a subceiling (Ordinary Income, Capital Gain, or Capital)
- Omitting the Schedule A or Schedule B page numbers for the vessel involved in the transaction in the column titled "Schedule Ref. No." This is particularly important when more than one vessel is involved. (For example, withdrawals for approved expenditures on objectives shown on agreement Schedule B, Page 1 may be designated "B-1".)

#### Amended Returns and IRS Audits

A copy of any amended return is needed for FVCCF files. Also, please advise us of any audit adjustments that affect CCF deposits, withdrawals, vessel basis, or depreciation.

#### Inactive Agreements

We will issue 60-day letters (warning of termination of the fund) as we identify agreement holders who have not complied with reporting requirements, are not meeting minimum deposit requirements, and/or are overdue on planned objectives.

#### Nonqualified Withdrawals

Any termination results in a nonqualified withdrawal of remaining funds. These deposits are taxed at the highest marginal rate, 39.6% for 1993 and 1994. In addition, an interest factor on the deferred taxes is added. For 1993 nonqualified withdrawals the rate was 6.73% for each year the funds were outstanding.

#### Reaching a FVCCF Financial Assistance Specialist

Most of our staff work between the hours of 7:30 am and 4:30 pm, Eastern Time. It is generally easiest to reach us during the morning hours. If you leave a message, please include the CCF number of the agreement holder so that we may pull the file before returning your call. You may also want to FAX messages to us after business hours (301/ 589-2686).

Due to the retirement during the past year of Jack Kelly and Dorothy Bostic, two of our senior staffers, you may be talking to new Financial Assistance Specialists. Mary Ellen McMillin is a certified public accountant and handles FVCCF Federal taxation issues. Rick VanGorder handles all aspects of one group of our agreements. Debbie Richardson will verify receipt of paperwork. Liz Brown, Mary Frye and Steven Schumacher continue to provide support to agreement holders while handling extra workloads during the orientation of the new specialists.

#### Representatives Listed in Our Database

We are in the process of updating Representatives for FVCCF agreement holders. The Representative is generally the financial professional who prepares the tax returns and advises you on CCF matters. If there has been a change since the initial agreement was signed, please send a letter to us with the change. We also need to know whether the Agreement Holder or the Representative should receive our mailings.